



John F. Sturm
President and CEO

April 13, 1998

The Honorable John M. McHugh
Chairman
Subcommittee on Postal Service
United States House of Representatives
Washington, DC 205 15

Dear Mr. Chairman:

Thank you for the opportunity to comment on the revisions to H.R. 22, The Postal Reform Act, which were distributed on December 11, 1997. On behalf of the more than 1,600 member newspapers of the Newspaper Association of America, we commend you for the thoughtful and careful approach that you have taken on postal reform legislation. Furthermore, we appreciate the open and constructive dialogue on the revisions that has taken place between your staff, NAA and other members of the Main Street Coalition for Postal Fairness.

NAA believes the proposed revisions to H.R. 22 are a positive step forward in addressing some of the concerns and suggestions expressed during the Subcommittee's hearings. NAA supports many of the provisions present in H.R. 22 and in the revised December outline. However, several areas continue to raise concerns for newspapers particularly the pricing flexibility and market test provisions. Other areas – particularly the applicability of a price cap system to a government entity – require further review and public discussion.

We look forward to working with you and your colleagues on the Subcommittee to address our concerns, and move forward with meaningful postal reform legislation.

Thanks again for the opportunity to share our views.

Sincerely,

Newspaper Association of America"
1921 Gallows Road, Suite 600, Vienna, VA 22182-3900
703•902•1601 FAX 703•902•1609
e-mail: sturmj@naa.org
PRINTED ON RECYCLED PAPER

**Comments of the
Newspaper Association of America
on Chairman McHugh's December 1997
Proposed Revisions to H.R. 22.
April 7, 1998**

The Newspaper Association of America (NAA) is a national trade association headquartered in Vienna, Virginia, that represents more than 1,600 newspapers in the U.S. and Canada, accounting for 87 percent of the U.S. daily circulation. While most NAA newspapers are dailies, many weekly newspapers are also members. Approximately sixty percent of NAA members have a circulation below 20,000.

Newspapers use Periodicals mail and Standard mail to deliver their editorial and advertising products. Newspapers also have a strong First Class interest since they, unlike most businesses, receive the vast majority of their revenue through the mail.

However, since the Postal Service has targeted newspapers' traditional advertising revenue for diversion, newspapers have been forced into the role of competitors to the postal system, a role not envisioned by Congress when it reorganized the Postal Service in 1970. The most recent evidence of this is found in a document entitled *United States Postal Service 1998 Marketing Plans* that has been entered into the record in the current rate case:

Objective

Ultimately to establish "day certain" delivery for selected categories of Ad Mail, and create the platform for moving substantial revenues from pre-printed newspaper inserts into mail.

United States Postal Service 1998 Marketing Plans, October 1997 at AD page 40.

The Postal Service has played a very important role in the social, political, and economic development of our country and still does so today. It has been and should remain a public service provided by the United States government for the benefit of its citizens—all its citizens. The Postal Service is not a "business," devoted to serving only those it chooses to serve. It should not give one customer a better "deal" than another. There is no place in our country's postal policies for the notion that those who can bring in more "trade" should be favored over those who can not. The principle of equal rates for equal service—no special deals allowed—should remain a bedrock of any American postal system.

The revisions proposed last December share a common theme and a common goal—that a government agency with a legal monopoly will not be allowed to compete with the private sector by exploiting its governmental advantages and its monopoly rate base. These revisions also recognize that a strong system of checks and balances is

absolutely necessary to make the postal regulatory system effective and to ensure that universal service of the mail on a non-discriminatory basis continues.

Among the most important changes are those seeking to :

- Broaden the PRC's mission and give it stronger enforcement powers.
- Prevent the Postal Service from favoring one competitor over another in its provisions of non-competitive postal services.
- Establish structural separations in order to prevent the Postal Service from cross-subsidizing its activities in the competitive area with its monopoly activities.
- Eliminate as much as possible the Postal Service's governmental advantages in the provision of services in the competitive area so that the private sector is protected to the maximum degree possible.

NAA fully supports the direction these changes have taken and we commend the chairman and staff for them. It is nonetheless important to point out that NAA has serious doubts about the basic approach that the proposal maintains and, overall, whether it will protect the principle of universal and nondiscriminatory mail service that the revisions aim to achieve.

Our views are explained more fully in the section-by-section comments that follow. Since no legislative language has been released, all of the views expressed below are contingent upon a review of actual legislative language.

H.R. 22 with Proposed Revisions

Title I: Organization. *This section makes a variety of changes to the USPS Inspector General's Office, the Postal Service, and the PRC.*

NAA supports the changes in this title, except the provision giving the Postmaster General the additional title of CEO.

While adding CEO to the Postmaster General's title is not substantive, it is highly symbolic. The Postal Service is a government agency, dedicated to public service. It is not a private business. In recent years the Postal Service increasingly has tried to position itself as a private business and has strayed far from its public service core mission. Looking at the Postal Service today, one would think that across-the-board competition with the private sector was part of its core mission. It isn't. Congress should refocus the

Postal Service on its core mission and not encourage it to move away from that mission—even symbolically.

NAA strongly supports the changes to the Inspector General's office. The Postal Service has consistently refused to cooperate with the PRC (and sometimes Congress) over the years and has been less-than-candid in the data and other information it makes available to the public. Stronger oversight of USPS is needed. The revisions proposed in this section would help. Vesting the hiring authority for USPS' public accounting firm in an independent force such as the Inspector General is a particularly good idea for it would minimize the risk of bias and conflicts of interest. Changing the PRC's name is appropriate, given the added enforcement powers that later sections of this bill give to it.

Title II: General Authority. *This section makes minor changes in provisions concerning police officers, post office closing appeals, and international provisions.*

NAA supports the changes in this title.

This section includes provisions designed to level the competitive playing field in the international arena. Under the proposal, the U.S. Trade Representative would represent our nation's interests in areas of international postal negotiations.

Title III: Presidential Postal Employee-Management Commission. *This section calls for an independent study of USPS employee-management problems.*

NAA supports the changes in this title.

Having a respected third party look objectively at postal labor issues could result in significant benefits for postal customers.

Title IV: Finance. *This section makes changes in the Postal Service's banking, borrowing, and investment authority, and creates a separate fund for competitive products.*

Banking and Investment Provisions

NAA supports the banking and investment provisions in this title, except the provision allowing the Postal Service's "private law" corporation to invest in specific private sector companies.'

¹ NAA does not believe that the Postal Service should have the authority to borrow **from** the Treasury or from private capital markets in order to fund a decrease in net worth-i.e., borrowing should never be done to cover operating expenses. Moreover, the subcommittee could consider a provision requiring the Postal Service to build a reserve fund to cover any year-to-year shortfalls that might develop between actual and projected revenues.

The changes in this section would continue to prohibit the Postal Service—a public service organization—from buying stock in private companies. That is clearly the correct position for this legislation to take. Under no circumstances should the Postal Service be allowed to have a direct financial stake—through either stock or bonds—in the success or failure of any specific private company any more than the Pentagon should be allowed to invest in a favored defense contractor, or the Treasury Department in a specific bank. If the USPS could have a direct financial interest in a particular company, it would have a strong incentive to favor that company over others in the marketplace. This is not appropriate for a government agency.

The revisions, however, would allow the “private law” subsidiary of the Postal Service to invest in private companies. NAA strongly opposes this provision. Even as a “private law” corporation, this subsidiary would be wholly owned by the Postal Service, thus giving the Postal Service a strong incentive to favor its subsidiary (and the companies it has invested in) over others in the marketplace.

Competitive Products Fund

The provisions on the Competitive Products Fund raise a number of questions and issues. First, as outlined in our comments on Title X, NAA has serious reservations about the division of postal services into competitive and non-competitive services, and more particularly about the Postal Service’s role in providing products in a competitive market where the private sector can adequately serve the market.

In addition, there are a variety of critical questions with regard to the creation of the Competitive Products Fund:

- The December revisions would also allow the Competitive Products Fund to borrow money from the general postal fund. This would appear to give the Competitive Products Fund unfair access to revenues from monopoly mail services and raises fundamental policy issues. Why should the general postal service fund be involved in financing competitive activities? What reason would the Competitive Products Fund have for borrowing money? The provision appears to be inconsistent with the revised proposal’s objective of preventing the cross-subsidization of competitive products by monopoly mail revenues.
- In establishing the Competitive Products Fund, how would one initially allocate assets and liabilities between competitive and non-competitive services that are common to both services? More importantly, how would one allocate common assets and liabilities on an ongoing basis, as new common assets are obtained and new common liabilities incurred? A fair and reasonable allocation of such joint and common costs goes to the core of a

monopoly's ability to cross-subsidize competitive ventures by non-competitive ventures.

- The revisions also provide that "the Competitive Products Fund shall be available for the payment of . . . institutional costs . . incurred by the Postal Service in providing postal products in the competitive category . . ." How would one initially (and on an ongoing basis) determine the institutional costs of competitive products?

A public hearing on these issues is essential.

Title V: Budget And Appropriations Process. *This title retains the authorizations for the Postal Service's Transitional, Public Service, and Revenue Forgone appropriations.*

NAA supports the changes in this title.

The Postal Service is a fundamental public service provided for the people by the government. This title reinforces congressional commitment to certain mail products that provide a public service.

Title VI: Miscellaneous Provisions Relating To Postal Rates, Classes, And Services. *This section makes changes in a variety of areas.*

NAA supports this title, except the provision granting volume discounts and contract rates to competitive products. NAA strongly opposes that provision.

The revisions in this section take out a provision in H.R. 22 that would have allowed the USPS to give some mailers in the non-competitive area volume discounts and contract rates. As the December revisions point out, "the purpose of volume discounting and negotiated service agreements is to permit the Postal Service the use of a widely used pricing strategy of private carriers 'in markets exposed to direct and growing competition.'" Giving the USPS the ability to use a competitive tool in a non-competitive market in order to favor one mailer over another is not sound public policy. Thus, the revisions continue current law for non-competitive products, where any "volume discount" could only be established if the PRC finds some tangible cost savings associated with that volume.

In terms of competitive products, NAA believes that contract rates and non-cost-based volume discounts simply have no place in the offering of a government agency whose mission is to provide a fundamental public service to the people of the United States. The Postal Service should not be allowed to discriminate among mailers in its offering of services.

NAA strongly supports the provisions in this section that expand the enforcement powers of the PRC. NAA and other mailers have consistently argued that the Postal Service has exploited the weakness of the current system by concealing data and refusing to divulge information notwithstanding a duty to do so. These provisions should correct this problem and are long overdue.

Finally, NAA suggests giving the PRC specific power to require the Postal Service to keep whatever systems of accounts, contracts, and other "business" data the PRC finds appropriate. While such authority arguably is already present in the grant of subpoena authority, providing the PRC explicit authority to set accounting standards will assure the PRC and the postal community that the appropriate data the PRC needs to do its job is collected. Such accounting requirements are common in other regulatory rate systems.

Title VII: Provisions Relating To The Transportation, Carriage, Or Delivery Of Mail. *This section makes minor changes to transportation and contracting provisions, and reduces the dollar limit on the private express statutes to 2.00.*

NAA supports the changes in this title.

Title VIII: Direct Appeal Of Decisions Of The Merit Systems Protection Board. *The December revisions dropped provisions dealing with the Merit Systems Protection Board.*

NAA takes no position on this matter.

Title IX: Law Enforcement. *This section makes a variety of changes to federal law enforcement provisions in the postal area.*

NAA supports the changes in this title.

Title X: New System Relating To Postal Rates, Classes, And Services. *This section divides the Postal Service's postal products into competitive and noncompetitive categories and establishes new rate setting procedures for both. It establishes a price cap system for noncompetitive postal products and allows extensive pricing flexibility for competitive products, while seeking to create appropriate safeguards. The section also provides for the creation of a separate "private law" subsidiary of the Postal Service and allows that subsidiary to offer nonpostal services and postal services in conjunction with others. The section makes various reporting and procedural changes and gives the PRC enhanced responsibilities and oversight.*

Competitive and Noncompetitive Services

H.R. 22, as originally introduced, separated postal services into competitive and noncompetitive categories. NAA commends the chairman for the December revisions which add important protections for customers of non-competitive services. The revisions intend to prevent the Postal Service from (1) favoring one customer of

noncompetitive postal products over another and (2) using its monopoly revenues to cross-subsidize its competitive services. NAA supports the purpose of these revisions and emphasizes the importance of the issues that they address.

It is our concern about these issues, however, that leads us to doubt the efficacy of separating competitive and noncompetitive postal services, which is a basic element of H.R. 22. Here are the central points.

- The Postal Service will not provide competitive services on an equal footing with the private sector. The Postal Service has many advantages because of its governmental privileges and immunities. For example, Priority Mail, Expedited Mail and Parcel Post are placed in the competitive category. Although these services today are offered in “competition” with the private sector, that “competition” is limited because the private express statutes forces the Postal Service’s “competitors” to offer their services at artificially higher prices.
- The division between competitive and noncompetitive services may not be adequate protection for the majority of postal customers. As noted earlier, a critical concern in trying to prevent the exploitation in the competitive marketplace of a government monopoly is how joint and common costs are allocated between competitive and noncompetitive services. Over the past twenty years, the Postal Service has favored some customers, such as large saturation mailers, to the disadvantage of the majority of mailers, including First-Class mailers, in making these allocations. The Postal Service will no doubt implement any new legislated structure in a manner consistent with its own priorities to the maximum extent possible. This allocation issue has not been satisfactorily addressed.
- While the revisions to H.R. 22 draw a bright line between competitive products and non-competitive products, the truth of the matter is that *all* postal products are subject to competition in some form and to some degree. There is a danger that the Postal Service would try to move a noncompetitive product into the competitive category, in order to favor one type of mailer over another. Exactly how much and what type (electronic, media, direct, etc.) of competition would be sufficient to move a product into the competitive category from the noncompetitive category is a decision for Congress to make, not a commission.
- There is a similar danger regarding the offering of new services or market tests of new products. The classification of whether a new service or market test is competitive or noncompetitive should follow this same line of demarcation. That is, only new services or market tests that are a variation of an existing type of competitive service should be allowed as a competitive new service or market test. A new express mail service, for instance, would be a new competitive service, while a new periodical mail service would not. Likewise, a new parcel post service would be a new competitive service, while a new advertising mail service would not.

- Finally, there is the issue of eliminating the Postal Service's antitrust immunity for competitive products. It is important for Congress to examine whether the antitrust laws can be successfully applied to all or part of a government agency. Neither the Justice Department nor the Federal Trade Commission has presented those agencies' views on this issue.

Pricing and Price Caps: A Workable System for the Postal Service?

The goal of price cap regulation is to achieve greater cost control and specific, tangible benefits for the **average** consumer. NAA supports both these goals. However, as explained below, NAA has serious doubts about applying a price cap to a governmental entity.

While price caps have been successfully applied to private sector utilities, it is not clear that they can be successfully applied to a government agency. Price caps are designed to regulate private sector companies through maximization of shareholder pressure on **management**.² Would they work for a government agency that has no shareholders, no profitability objective, and no financial discipline from the markets?

H.R. 22 addressed this problem by creating a bonus system for employees that was intended to act as a substitute for the Postal Service's lack of shareholders. However, in a hearing last year before the Subcommittee, *none* of the economists who testified could confidently predict that the price cap system in H.R. 22 would work for a government entity. The views that were expressed by these economists at these hearings do not provide adequate basis for the Subcommittee to proceed with a price cap system for the Postal Service. Additional inquiry is necessary about the applicability of price caps to a government entity.

Competitive Nonpostal Services.

NAA believes that the Postal Service should have no role in offering nonpostal services to the public, even under a separate subsidiary, other than perhaps incidental services that

² Price caps are designed to give regulated utilities an incentive to maximize profit through prudent management and cost control, in order to maximize shareholder return. This allows shareholders to earn a profit that is above the limit for profits of traditional rate-of-return regulation. William J. Baumol & J. Gregory Sidak, TOWARD COMPETITION IN LOCAL TELEPHONY (1994) at 88. This in turn gives investors a strong incentive to ensure that management is doing everything possible to manage prudently and control costs. Where investors find that management isn't doing everything possible to manage prudently and control costs, management is replaced. That does not happen in the Postal Service. Testimony of Professor John C. Panzar before the House Committee on Government Reform and Oversight, Subcommittee on the Postal Service (April 16, 1977) (Given the Postal Service's current status as a public enterprise, the objectives pursued via the introduction of price caps or other forms of incentive regulation are fundamentally different than in the case of privately owned utilities).

don't compete with the private sector. If the private sector can adequately provide a service, then the government should not.

Nevertheless, the bill does provide for the offering of such services through a separate subsidiary. While NAA commends the chairman for trying to protect monopoly mailers from USPS forays into nonpostal areas through this separate subsidiary structure, the structure described in the revisions is far from separate. Not only can the Postal Service's directors and employees overlap substantially with the subsidiary, but there are no provisions preventing improper sharing of information or cross-dealings between the Postal Service and this subsidiary. This lack of separation is troublesome.

This is an area where Congress has a great deal of expertise. During the recent debate on restructuring the telecommunications industry, Congress considered the issue of separate subsidiaries at length. There is a wealth of information on effective structural safeguards and separations in that record.

The December revisions also raise other important public policy questions, for this separate subsidiary would not only offer nonpostal products to the public, but also postal products in cooperation with the private sector. This entity would be able to offer postal products on a discriminatory basis to the public, selecting with whom it chose to deal, at what price it chose to deal, on what terms it chose to deal. Since this subsidiary would be wholly owned by the Postal Service, the Postal Service would have a strong incentive to favor this subsidiary (and the companies it has chosen to deal with) over all others in the marketplace.

NAA opposes this provision.

Other Matters

At the end of the Summary of the December proposed revisions is a section dealing with Universal Service. While a one year on-the-record review to define and quantify the concept of "universal service" strikes NAA as a good idea, the materials seem to indicate that any element of "universal service" could be excluded from the general requirements that competitive services cover their attributable costs and make a proportionate contribution to institutional costs.

If Express Mail, Priority Mail, or Parcel Post were deemed elements of universal service, could the Postal Service price them below cost under this provision? NAA believes that *all* services offered by the Postal Service should cover their costs and make a contribution to the institutional costs of the system.

Additional Considerations: USPS Marketing

The USPS is currently using revenues collected from all mailers to fund an advertising and marketing campaign designed to increase direct mail volume, and drive advertising dollars out of newspapers. As USPS' 1998 Marketing Plans indicates:

The Postal Service is taking a position of leadership in the Direct Mail industry as the owner of the medium. ... the Postal Service can no longer rely on others to grow the business enough to meet our revenue needs in the future. .. The USPS will take a leading role, as owner of the medium, in developing and implementing advertising and other programs to improve the image of direct mail advertising. .

* * *

Newspapers, particularly pre-printed inserts, are the primary and most direct threat to the USPS position in the advertising market in the next five years. . Newspapers derive approximately 80 percent of their total revenue from advertising and all of it is susceptible to serious diversion

United States Postal Service 1998 Marketing Plans, October 1997 at pages AD2, 7, 8, 29.

Indeed, at least \$15 million government dollars will be pumped into national advertising alone to promote the image of direct mail. *Id.* at 29. In addition, as part of this marketing campaign, a sales force of USPS employees will work with direct mailers and actually solicit business for private sector direct mail firms:

Account Management/Sales Management

Description

The USPS has a very large base of sophisticated users of Ad Mail; it also has very large customers who do not currently use Ad Mail as a significant part of their advertising programs. Customer Relations will identify these customers and target them with specific sales plans.

* * *

Sales Partners

Description

A joint program between field and headquarters Marketing, working with third-party Sales Partners [presumably direct mailers] to generate new revenue, primarily from non-managed accounts and new customers.

Id. at AD30, 3 1.

Mailers who use, produce or sell advertising that competes with advertising mail are essentially paying for marketing efforts against themselves. The Postal Service's advertising and marketing campaign is not an appropriate function for a governmental agency. The multi-billion dollar direct marketing industry is fully capable of financially supporting its own advertising campaign and sales force. The government should not be doing it for them.

This taking of sides in the competitive marketplace is *not* appropriate behavior for an agency of the federal government; it is not what Congress intended in the Postal Reorganization Act. Congress should stop this immediately.

Thank you for considering our views.